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To: Each Supervisor

From: Joan Ouderkirk 
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Subject: **ENERGY UPDATE REPORT**

This is the seventh in a series of regular reports requested by your Board to provide updates on the County's ongoing energy management activities. These reports will be provided quarterly and discuss the status of key energy related issues and responses to recent Board Motions and requests.

Electricity Rates

The Federal District Court's ruling approving the settlement agreement between Southern California Edison (SCE) and the California Public Utilities Commission (CPUC) is still being heard in the Ninth Circuit Court of Appeals. The Utility Reform Network (TURN) and various power producers provided arguments against the settlement. A ruling is expected at any time. The County would be involved in this issue again only if the approval of the settlement agreement is overturned on appeal.

If the agreement is upheld, SCE's rates will not increase until not earlier than January 1, 2003. SCE will then adjust rates up or down depending on a variety of issues. Key among these are: the current market prices for energy that SCE must still purchase to meet users needs, the revenue requirements of the State's long term power contracts, and the pending state bond issuance to repay past energy purchases. Until a decision is reached, SCE's rates will include the full 4-cent surcharge approved in the spring of last year.

In May 2002, SCE filed a general rate case application at the CPUC for a rate adjustment beginning in 2003 to cover investments in their transmission and distribution systems and increased maintenance and operation costs. This would not impact SCE's current collections for self-generated and purchased power. Edison's request at the CPUC represents about a 2.6% increase in SCE's current revenues, or an additional \$286 million. SCE anticipates reducing their electric rates at that time (due to lower energy costs) thus mitigating any net rate increase customers may see as a result of this proposed revenue increase request. The County is contemplating participation in this proceeding.

The Los Angeles Department of Water & Power (DWP) is currently studying a rate adjustment that may have an impact on the County. We have no information at this time on whether rates will be adjusted up or down.

Pitchess Qualifying Facility (QF) Status

As reported in the last report, SCE has repaid the County all outstanding debt related to past non-payments and settlement of the plant deration issue. A condition of the deration settlement is that the CPUC approve the settlement. This June, CPUC Administrative Law Judge Wong issued a proposed draft decision supporting the settlement agreement. Simultaneously, CPUC Commissioner Wood issued an alternate draft decision denying approval of the agreement. One basis for the Commissioner's decision is that since the settlement agreement proposes no changes to the QF contract, SCE is not required to obtain CPUC approval of the settlement.

The County submitted comments on June 20th urging the CPUC to approve the settlement agreement. A CPUC decision is expected on June 27, 2002. Should the CPUC not approve the settlement, Edison and the County would be restored to pre-settlement positions. We will advise your Board of any further developments in this regard.

Natural Gas

ISD purchases natural gas for the County's largest users and for the cogeneration plants at Pitchess, Civic Center, and Olive View Hospital. The current, fixed price contract for all sites except Pitchess expires on June 30, 2002. ISD has solicited new fixed price contracts for one and two year terms beginning July 1, 2002. Price proposals were about \$3.80 per MMBtu for one year and \$4.00 for two years. These prices are significantly higher than the current market and therefore, ISD has negotiated a one-month extension of the current supply contract for about \$3.00 per MMBtu. ISD can continue to extend monthly at market prices but will seek to secure a longer-term fixed price contract before this winter (before November 2002). We will keep you apprised of any dramatic shifts in natural gas prices and any change in ISD's procurement strategy.

Pitchess cogeneration plant is on a market index contract through October 2002. This is essentially a cost neutral arrangement as SCE reimburses the plant for actual natural gas procurement expenses.

Retrofits

At the May 28, 2002 Board meeting, your Board authorized the Director of ISD to enter into contracts totaling \$4.077 million for energy retrofit projects throughout the County. Contracts have been signed with three energy service companies (ESCOs). Project work will begin around September 2002 and should be concluded by December 2003. Major facilities to be retrofitted with new lighting systems include the Music Center, Olive View Hospital and the Museum of Natural History. New lighting control systems will be installed at the Registrar Recorder headquarters and the courthouses in Compton, San Fernando, Beverly Hills, Long Beach and Norwalk.

As first reported to your Board in a memorandum dated May 28, 2002, ISD has been awarded \$3.3 million by the CPUC for additional energy efficiency projects in SCE territory. The funding was made available as part of the CPUC's 3rd Party Local Energy Efficiency Funding Program (Program) for calendar years 2002 and 2003. The Program diverts a portion of energy efficiency funding that is typically administered under the utilities rebate programs. The CPUC evaluated applicants and awarded funding directly to energy companies and other 3rd parties that showed they could create immediate and significant savings.

ISD will be required to sign a contract with SCE who will administer and disperse the CPUC funding and review the projects' progress. This contract is currently being negotiated by ISD, County Counsel and the CPUC. We will seek your Board's approval to enter into this agreement sometime in July 2002.

Retrofit projects authorized by your Board in fiscal year 2000-01 totaling \$6.7 million are nearly completed. These include projects at Pitchess Honor Ranch, Men's Central Jail and Twin Towers. Also, retrofit projects funded by the Quality and Productivity Commission's Productivity Improvement Fund are completed. These included projects at Antelope Valley Civic Center, Pasadena and Van Nuys Courts, and the Health Services Administration Building.

Micro-turbine Project

ISD has negotiated a commitment for funding from the SCAQMD for the installation of three 30kW micro-turbines. A contract has been signed and the turbines will be installed at Men's Central Jail and Twin Towers by late summer. The units are estimated to save over \$100,000 annually and were acquired, at no cost, as part of a joint SCAQMD and LADWP project to promote this technology.

Long Beach Courthouse Energy Recognition

The Department of Energy (DOE) awarded its "Energy Star Building" label to the Long Beach Courthouse earlier this year. This significant energy industry award recognizes the courthouse as one of the top 25% energy efficient buildings in the country. ISD had retrofitted the courthouse in 1996 with energy efficient lighting, air conditioning systems, and an energy management control system. The DOE's "Energy Star" Building program compiles building operating data into a nation-wide facilities database, evaluates energy performance, and recognizes the top performing facilities. ISD is compiling and submitting data to the DOE database on many of the other County facilities that have undergone comprehensive energy retrofits.

I6 Insurance Lawsuit

With your Board's approval, the County has filed a lawsuit against Caliber One Indemnity Company (Caliber One) for breach of contract. Under an insurance policy, Caliber One agreed to provide insurance covering penalties assessed to County accounts as part of SCE's Interruptible Tariff (I6) program.

Under the I6 program, SCE assessed penalties to the County during the fall of 2000 through spring of 2001 as the State experienced numerous supply shortages and energy curtailment periods. During this time, the County accumulated slightly over \$5 million in assessed penalties and other costs associated with eventually terminating the I6 program. The County ended participation in I6 to avoid further potential penalties. A claim for \$5 million was submitted to Caliber One and they submitted payment for half the claim but refused payment of the remaining \$2.5 million. Subsequent discussions with Caliber One led to the filing of the lawsuit by the County. We will keep your Board apprised of any significant events on this issue.

Natural Gas Lawsuit

The County filed a lawsuit against several natural gas transporters and marketers alleging their participation in a conspiracy to eliminate competition and raise gas and electricity prices in southern California. The complaint named the Southern California Gas Company, San Diego Gas & Electric, Sempra Energy, and various affiliates of the El Paso Corporation as defendants. The County's lawsuit was ordered coordinated with natural gas lawsuits filed by other plaintiffs, including the cities of Los Angeles and Long Beach. We will keep you apprised of progress on this issue.

CPUC Issues

The County remains a participant, or is monitoring issues, in the following ongoing proceedings at the CPUC:

SCE Rate Increase

SCE's request in October 2000 for a rate increase to cover ongoing energy procurement losses ultimately led to the surcharges now implemented in their rates. A number of related issues continue to grow out of this proceeding of which the County is an intervener. Adjustments to the current surcharges will be proposed and discussed in this proceeding. We will keep you apprised of any significant events.

QF Repayment Proceeding

The CPUC, in January 2001, ordered that QFs be repaid based on natural gas prices at the California/Oregon border; this resulted in ongoing revenue losses at the Pitchess cogeneration plant. SCE eventually resolved this by amending QF contracts restoring payments based on prices at the California/Arizona border for a term of 5 years. However, the CPUC's order is still in effect and would impact the County at the end of the 5-year term. Accordingly, the County along with other co-generators have challenged the CPUC order in State Court.

Utility Procurement Procedures

The CPUC has established a proceeding to determine how SCE will procure energy for its retail customers. As mentioned earlier, much of SCE's financial problems of the past were caused by the requirement to purchase energy from the spot market and the restriction against purchasing under long-term contracts.

This proceeding may also impact future rules on direct access, self-generation, and energy efficiency programs in California; thus the County is an intervener in this proceeding.

Additional SCE Proposed Rate Change

In May 2002, SCE filed at the CPUC to collect additional revenues (beginning in 2003) to cover higher operating and maintenance expenses. These are expenses related to operation of their business exclusive of fuel and purchased power expenses. They are

requesting an additional \$286 million in revenues. ISD is currently working with SCE to determine the impact to the County of this action.

Possible Change in Electric System Voltage

Last summer, the state's investor owned utilities investigated the feasibility of uniformly lowering their voltage levels throughout their electric systems, including to business and residential customers. The proposed voltage drop of 2 to 3% was investigated as an energy conservation measure and was predicted to have no noticeable impact on customers. After a series of isolated pilot tests and as a result of the statewide conservation efforts last year that mitigated some of the supply concerns, the utilities have announced that no system voltage reduction plan would be implemented.

Federal Energy Regulatory Commission (FERC) Issues

The status of the ongoing FERC Electric Market Investigation and Natural Gas Market Abuse proceedings are provided below. In addition, we are providing a description of new issues before FERC that ISD is following and may request your Board's authority to intervene.

FERC Electric Market Investigation

FERC has been investigating market irregularities in the California wholesale markets since January of 2001. In March 2002, hearings were initiated to determine the amount of refunds due ratepayers. The Governor has stated that California is due \$8.9 billion in refunds. The current phase of this investigation seeks industry expert data related to refund calculations. Testimony will be filed this July. Evidentiary hearings are scheduled in San Francisco in late August.

Natural Gas Market Abuse

FERC is investigating a complaint by the CPUC that El Paso Natural Gas Company and its marketing affiliate, El Paso Gas Marketing, illegally conspired to raise prices to boost their profits during the energy crisis. The County intervened in this proceeding and has been actively participating in the case. After an initial hearing, the assigned Administrative Law Judge determined that El Paso Gas Co. had market power, but there was insufficient evidence to establish that they had abused that power. On December 27, 2001, FERC ordered a further hearing on the issue of whether El Paso Gas Co. made all of its pipeline capacity available to other gas shippers at its California

delivery points. The hearing on this occurred on March 19, 2002. All parties are now awaiting the Judge's decision.

Fact Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices

This FERC investigation was prompted by the recent discovery of Enron correspondence indicating potential market abuse. In this FERC investigation, no outside parties were permitted to intervene in this proceeding. Rulings are expected shortly with respect to the next phase. ISD will advise your offices as developments occur.

Complaints on Unjust and Unreasonable Prices in Sales Contracts

This proceeding focus on the reasonableness of the long-term power contracts the State entered into during the height of the energy crisis. These contracts are currently well above market prices. Complaints and testimony are to be provided through mid-September of this year. The hearing is scheduled to begin on October 7, 2002.

California Attorney General Complaint

In March 2002, the State Attorney General filed a complaint attacking the use of market-based rates in California at the time of the crisis. On May 31, 2002, FERC dismissed the case ruling that it represented an invalid attack on prior Commission orders authorizing market-based rates.

Additional Court Proceedings of Interest

A number of other federal and state court proceedings related to California's energy crisis have arisen. The State Attorney General has filed a significant number of them. ISD and County Counsel will follow the progress of these and report back to your offices on any significant events.

CA Attorney General vs. Various Power Suppliers

The State Attorney General has filed complaints against the following energy producers and marketers: Reliant, Mirant, Williams, Dynegy, Coral Power, and Powerex. The charges include illegal acquisitions and holdings and violation of California Business and Professions Code. The complaints seek divestiture, civil penalties, damages, and restitution. The complaints are filed in California Superior Court and in United States District Court, Northern District.

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State of CA, San Francisco City Attorney vs. Various Power Suppliers

This complaint was originally filed in California Superior Court and is currently pending in San Diego Superior Court. It alleges unfair, unlawful and deceptive trade practices by the following energy marketers: Dynegy, Enron, PG&E, Reliant, Sempra, Southern Company, Williams, Duke, NRG Energy, and Morgan Stanley.

Hendricks vs. Various Power Suppliers

This is a class action complaint for unlawful business practices and violations of California antitrust law. It was filed in California Superior Court in San Diego in November 2000 against the same energy marketers mentioned above. The State of CA, San Francisco City Attorney complaint will likely be consolidated with this complaint.

If you have any questions, please contact me or have your staff contact Howard Choy at (323) 881-3939.

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c: Chief Administrative Officer
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